

ABC Company
Balance Sheet
December 31, 1973

Assets

Current assets:	
Cash	\$ 1,780
Accounts receivable	3,100
Merchandise inventory	4,550
Prepaid expenses	100
Total current assets	\$ 10,130

Fixed assets:

Store equipment	\$ 4,200
Less accumulated depreciation	900
Office equipment	2,000
Less accumulated depreciation	500
Delivery Truck	3,000
Less accumulated depreciation	1,000
Total fixed assets	6,800
Total assets	\$ 16,930

Liabilities

Current liabilities:	
Accounts payable	\$ 1,500
Notes payable	1,000
Contracts payable	2,000
Total current liabilities	\$ 4,500

Fixed liabilities:

Contracts payable	\$ 2,000
Long-term note payable	1,300
Total fixed liabilities	\$ 3,300
Total liabilities	\$ 7,800

Net worth

Total liabilities + net worth

6,800

9,140

\$ 16,930

"Basic Relationships in Accounting."

In the broadest sense, an asset may be defined as anything of value such as cash, land, equipment, raw materials, finished products, or any type of property. At any given instant, a business concern has a certain monetary value because of its assets. At the same instant, many different persons may have a just claim, or equity, to ownership of the concern's assets. Certainly, any creditors would have a just claim to partial ownership, and the owners of the business should have some claims ownership. Under these conditions, a fundamental relationship in accounting can be written as:

$$\boxed{\text{Assets} = \text{equities.}} \quad (1)$$

Equities can be divided into general classes as follows:

- (1) Proprietorship - the claims of the concern or person who owns the asset; and
- (2) liabilities - the claims of anyone other than the owner.

The term proprietorship is often referred to as net worth or simply as ownership or capital. Thus equation (1) can be written

$$\boxed{\text{Assets} = \text{liabilities} + \text{proprietorship}} \quad (2)$$

The meaning of this basic equation can be illustrated by the following simple example. 5 Students have gone together and purchased a secondhand automobile worth \$1000. Because they did not have the necessary \$1000, they borrowed \$400 from one of their parents. Therefore, as far as the students are concerned, the value of their asset is \$1,000, their proprietorship is \$600, and their liability is \$400.

Eq. 2 is the basis for balancing assets against equities at any given instant. A similar equation can be presented for balancing costs and profits over any given time period. The total income must be equal to the sum of all costs and profits, or

$$\boxed{\text{Total income} = \text{costs} + \text{profits}} \quad (3)$$

Any accounting study can ultimately be reduced to one of the forms represented by equations 1, 2, or 3.

The Balance Sheet

A balance sheet for any industrial concern is based on equations ① and ② and shows the financial condition at any given date. The amount of detail included varies depending on the purpose. Consolidated ~~income~~ balance sheet based on the last day of the fiscal year are included in the annual report of a corporation. These reports are intended for distribution to stockholders, and the balance sheets present the pertinent information without listing each individual asset and equity in detail.

① Assets are commonly divided into the classification of current, fixed and miscellaneous.

Current assets, in principle, represent capital which can readily be converted into cash. Examples would be accounts receivable, inventories, cash, and marketable securities. These are liquid assets.

On the other hand, fixed assets, such as land, buildings, and equipment, cannot be converted into immediate cash.

Deferred ~~assets~~ charges, other investments, notes and accounts due after 1 year, and similar items are ordinarily listed as miscellaneous assets under

separate headings.

Modern balance sheets often use the general term liabilities in place of equities. Current liabilities are grouped together and include all liabilities such as accounts payable, debts, and ~~taxes~~ taxes due within months of the balance sheet date.

The net working capital of a company can be obtained directly from the balance sheet as the difference between current assets and current liabilities.

Other liabilities, such as long-term debt, deferred credits, and accrued ~~liabilities~~ under separate headings.

Reserves, ~~surplus~~ surplus, ~~undistributed profits~~ undistributed profits, and ~~other~~ other ~~equity~~ equity items are listed under the equity section of the balance sheet.

Consolidated balance sheet are ordinarily presented with assets listed on the left and liabilities, including proprietorship, listed on the right. As indicated in equation ①, the total value of the assets must equal the total value of the equities.

The value of property items, such as land, buildings, and equipment, is usually reported as the value of the asset at the time of purchase. Depreciation reserves are also indicated, and the difference between the original property cost and the depreciation reserve represents the book value of ~~the~~ property.

The ratio of total current assets to total current liabilities is the called the current ratio.

The ratio of immediately available cash to total current liabilities is known as the cash ratio.

The current and cash ratios are valuable for determining the ability to meet financial obligations, and these ratios are examined carefully by banks or other loan concerns before credit is extended.

②

The Income Statement.

A balance sheet applies only at one specific time, and any additional transactions cause it to become obsolete. Most of the changes that occur in the balance sheet are due to revenue received from the sale of goods or services and cost incurred in the production and sale of the goods or services. Income-sheet accounts of all income and expense items, such as sales, purchases, depreciation, wages, salaries, taxes, and insurance, are maintained, and these accounts are summarized periodically in income statement.

A consolidated income statement is based on a given time period. It indicates surplus capital and shows the relationship among total income, costs, and profits over the period. The information presented in income sheet is used to determine the interest in

the engineer, since they represent the facts which were originally predicted through cost and profit analyses.

The terms gross income or gross revenue used by accountants refer to the total amount of capital received as a result of the sale of goods or service.

Net income or net revenue is the total profit remaining after deducting all costs, including taxes.

The role of interest on borrowed capital is clearly indicated. Since the accountant considers as an expense arising from the particular method of financing, the cost due to interest is listed as a separate expense.

Examples :-

1. Prepare a balance sheet applicable at the date when the X Corporation had the following assets and equities

Cash	\$ 20,000	(1)	Common stock sold	\$ 50,000	(2)
Accounts payable:			Machinery and equipment		
B Company	2,000	(3)	(at present value)	18,000	(3)
C Corporation	8,000	(4)	Furniture and fixtures		
Accounts receivable	6,000	(5)	(at present value)	5,000	(6)
Inventories	15,000	(7)	Government bonds	3,000	(8)
Mortgage payable	5,000	(9)	Reserves	2,000	(10)

Solution.

Assets

Liabilities

Assets

* Current assets

Cash

Notes and accounts receivable

inventories

* Investment and longterm investment

* Properties, plants, and equipment

Prepaid and deferred charges

* Prepaid and deferred charges

Ex. The following information applies to E Company on a given date:

Long-term debts \$ 1,600

Debts due within one year \$ 1,000

Accounts payable 2,300

Machinery and equipment (at cost) 10,000

Cash in bank 3,100

Prepaid rent 300

Government bonds 3,000

Social security taxes payable 240

Reserve for depreciation 600

Reserve for expenses 1,200

Inventories 1,600

Accounts receivable 1,700

Liabilities

* Current liabilities

Accounts payable

Long-term debt (due within 1 year)

Accrued taxes

Other accruals

* Long-term debt

* Deferred credits

* Reserve for contingencies

Determine the current ratio, cash ratio, and Working Capital for Company E at the given date?

Solution

Current Assets

Cash	\$ 3100
Government Bonds	3000
Inventory	1600
Accounts receivable	1700
Total	9400

Current liabilities

Accounts Payable	\$ 2300
Soc. Sec. Taxes Payable	240
Debts due in 1 yr.	1000
Total	3540

$$\text{Working Capital} = 9400 - 3540 = \$ 5860$$

$$\text{Current ratio} = 9400 / 3540 = 2.65$$

$$\text{Cash ratio} = (3100 + 3000) / 3540 = 1.72$$

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